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No. 92-641

In the
Supreme Court of the United States

OCTOBER TERM, 1992

LEONARD NOBELMAN AND HARRIET NOBELMAN,
Petitioners,

v.

AMERICAN SAVINGS BANK,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES
COURT OF APPEALS FOR THE FIFTH CIRCUIT.

[redacted] **Brief of Consumer Education and Protective Association, Ruby Lee Bradley, Ethel Cook, Clifford Moses, and Chapter 13 Trustee Gary Gaertner as Amici Curiae in Support of Petitioners.**

HENRY J. SOMMER
Counsel of Record
COMMUNITY LEGAL SERVICES, INC.
3207 Kensington Avenue
Philadelphia, Pennsylvania 19134-2483
(215) 427-4898

(Counsel continued on inside cover.)

BATEMAN & SLADE, INC BOSTON, MASSACHUSETTS

BEST AVAILABLE COPY

DAVID S. YEN
LEGAL ASSISTANCE FOUNDATION
OF CHICAGO
852 West 63rd Street
Chicago, Illinois 60621

GARY KLEIN
JOANNA GEORGE
NATIONAL CONSUMER LAW CENTER
11 Beacon Street
Boston, Massachusetts 02108

DANIEL L. HALLER
NEIGHBORHOOD LEGAL SERVICES
ASSOCIATION
928 Penn Avenue
Pittsburgh, Pennsylvania 15222

LAWRENCE YOUNG
NORTH MISSISSIPPI RURAL LEGAL
SERVICES
2134 West Jackson Avenue – P.O. Box 767
Oxford, Mississippi 38655

Attorneys for *Amici Curiae*

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INTERESTS OF AMICI CURIAE

Amici Ruby Lee Bradley, Ethel Cork and Clifford Moses are individuals who have filed bankruptcy cases under Chapter 13 of the Bankruptcy Code. They propose to strip down junior mortgages held solely on their homes. Their cases illustrate the illogical and inequitable results compelled by the decision of the court below, which forces consumer debtors in Chapter 13 cases to treat an unsecured or partially secured claim the same as a fully secured claim.

Mrs. Ruby Lee Bradley purchased her home in December, 1987. She owes $32,000 on the first mortgage. In May, 1989 she obtained a loan of $6,000 from Greentree Acceptance Company to have aluminum siding placed on her house. Although the home had not appreciated in value, Greentree took a second mortgage on the property.

Mrs. Bradley's current monthly income is $878.99 from a combination of wages and social security benefits for her dependents. She has six (6) children.

Mrs. Bradley cannot pay both the first and second mortgage on her home. She filed a Chapter 13 bankruptcy in the Northern District of Mississippi on July 27, 1992. The appraised market value of her home at that time was $29,500. Bradley's Chapter 13 plan proposes to pay the first mortgage of $32,000 in full. The second mortgage - which has never encumbered any property value - will be stripped down and treated as an unsecured claim. If the second mortgage is stripped down the monthly Chapter 13 payments would be $485.22. If the second mortgage must be treated as a fully secured claim the monthly Chapter 13 payments would be $600.22. Mrs. Bradley does not have

sufficient income to pay $600.22 a month into a Chapter 13 plan and meet her other living expenses. On the other hand, she can pay the proposed Chapter 13 payments of $485.22 per month and meet daily expenses. Thus, whether the second mortgage can be stripped down will determine whether Bradley can successfully complete a Chapter 13 plan.

The United States Bankruptcy Court denied confirmation of Bradley's Chapter 13 plan because it proposes to strip down the second mortgage. The bankruptcy court cited the decision of the court below in support of this ruling. Her case is on appeal to the United States District Court. The likelihood of success on appeal depends on the Court's decision in this case.

Ms. Ethel Cork purchased her home in 1984. She owes $36,000 on the first

mortgage. The monthly payments on the first mortgage are $555.00. In 1990 she obtained an $8,600 home improvement loan from Greentree Acceptance Company. That loan is repayable over fifteen (15) years at a 15% annual percentage rate of interest. Payments on this loan are $125.00 per month, and the total sum to be paid over fifteen (15) years is $22,000. Although Cork's home had not appreciated in value, Greentree took a second mortgage on the property.

Ms. Cork has a fixed income of $800.00 a month in social security benefits. She is unable to make the payments on both the first and second mortgages on her home. On November 18, 1992 she filed a Chapter 13 bankruptcy in the Northern District of Mississippi. The appraised market value of her home when she filed was $32,500. Ms. Cork is not

behind on the first mortgage of $36,000 and her Chapter 13 plan proposes to maintain payments on the first mortgage. She is, however, approximately $3,000 in arrears on the second mortgage. Ms. Cork proposes to strip down the second mortgage and treat it as an unsecured claim. If the second mortgage cannot be stripped down, Ms. Cork does not have sufficient income to make payments in her Chapter 13 case on both mortgages. However, she has the ability to pay the first mortgage.

Mr. Clifford Moses purchased his home in 1985 for $10,000, financed by a mortgage for all or virtually all of the purchase price. Several years later he obtained a loan of $3,000 from a finance company. Although the home had not appreciated in value, the finance company took a second mortgage on the home. Mr. Moses experienced financial problems and

defaulted on both loans. He recently filed a Chapter 13 case in the Eastern District of Pennsylvania. The parties to that case recently stipulated that there was no equity over and above the first mortgage, and Moses' plan providing for the second mortgage claim as an unsecured claim is awaiting confirmation.

Absent the ability to strip down the second mortgage on his home, it is very doubtful whether Mr. Moses could save his home in bankruptcy, since he does not have sufficient income to cure or pay off both his first and second mortgages. Yet, under the decision of the court below, that would be the only way to deal with both debts in a Chapter 13 case.

Mrs. Bradley, Ms. Cork and Mr. Moses are low-income homeowners. They have sufficient income to protect their homes in Chapter 13 proceedings by paying the

first mortgage claim. They seek reversal of the decision below which would deprive them of the protection of Chapter 13. They should not lose this protection by being forced to pay junior mortgages that do not encumber any value in their homes.

Amicus Consumer Education and Protective Association, Inc. (CEPA) is a membership organization of primarily low-income consumers based in Pennsylvania. CEPA is dedicated to advancing the cause of consumer rights, and in particular, the support and protection of those statutory remedies designed to enable economically distressed homeowners to save their homes from foreclosure. Chapter 13 of the Bankruptcy Code has enabled hundreds of CEPA's members to address the burden of their debt, including, most critically, the opportunity to set up affordable payment plans for curing defaults on their

home mortgages.

CEPA's particular interest in this case is that a decision requiring full payment of undersecured claims would substantially increase the burden that Chapter 13 places on low-income debtors and, in many cases, would put this remedy beyond the reach of its members who, but for the added payment requirement, could save their homes.

Amicus Gary J. Gaertner is the Chapter 13 Standing Trustee in the United States Bankruptcy Court for the Western District of Pennsylvania. He has the statutory duty to review and administer Chapter 13 plans and to represent the interest of the bankruptcy estate. During 1992 he had 1,734 open cases and distributed $10,777,379 to creditors. Of that amount, $7,398,277 was paid to secured creditors. The Chapter 13 Trustee

has the additional responsibility to oppose preferential treatment in a Chapter 13 plan favoring a subclass of unsecured claims. Affirmance of the Fifth Circuit's decision would result in discrimination in favor of a subclass of unsecured claims (i.e., the unsecured portions of undersecured claims), when there is no economic, statutory or rational social policy reason to do so. Mr. Gaertner believes that an affirmance of the Fifth Circuit's decision would also create undue pressure on debtors to liquidate under Chapter 7 by forcing them to pay for illusory "secured" debt, when they could reorganize and pay under a Chapter 13 plan based on economic realities. Such an outcome would be contrary to Congress' intent in revising the Bankruptcy Code to encourage the use of Chapter 13.

ARGUMENT

SUMMARY OF ARGUMENT

The correct interpretation of sections 506(a) and 1322(b)(2) of the Bankruptcy Code should start and end with their plain language. The natural reading of these sections is that the ban against modification found in section 1322(b)(2) applies only to the portion of the claim that has secured status after application of section 506(a).[1]

The decision of the Fifth Circuit below, Matter of Nobleman, 968 F.2d 483 (5th Cir. 1992), found conflict between

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[1] This is the interpretation adopted by the Second, Third, Ninth and Tenth Circuits. In re Hougland, 886 F.2d 1182 (9th Cir. 1989), reaffirmed in Lomas Mortgage U S A v. Wiese, ___ F.2d ___, 61 USLW 2364 (9th Cir. 1992); Wilson v. Commonwealth Mortgage Corp., 895 F.2d 123 (3d Cir. 1990), reaffirmed in Sapos v. Provident Inst. of Savings in Town of Boston, 967 F.2d 918 (3d Cir. 1992); In re Bellamy, 962 F.2d 176 (2d Cir. 1992); In re Hart, 923 F.2d 1410 (10th Cir. 1991).

§§ 506(a) and 1322(b)(2) that does not exist. There is no conflict because, even after a creditor's claim has been stripped down by application of § 506(a), the creditor is protected by § 1322(b)(2) against modification of rights that flow from the underlying transaction, such as the interest rate and payment schedule.

The interpretation urged by amici carries out the Congressional compromise embodied in § 1322(b)(2) without undermining the fundamental purposes of the Bankruptcy Code of providing a fresh start for the honest debtor and equity among similarly situated creditors.

Section 506(a) is a crucial tool in fulfilling the intent of Congress that rights in bankruptcy be based on economic reality, without extraneous non-financial pressures. Congress intended that § 506(a) have uniform application

throughout the Bankruptcy Code. Application of § 506(a) results in a recognition of the underlying economic reality, not a modification of any property rights. These sections can be harmonized by having the special protection for home mortgage lenders in § 1322(b)(2) apply only to the portion of the claim that has economic value. This interpretation honors Congress' intention that the Code be based on economic reality.

Applying the plain language of the Code has not and will not lead to the dire consequences that the home mortgage lending industry has conjured up. Because § 506(a) does not destroy real economic value, the ability to strip down home mortgages by using § 506(a) has not had any economic impact on the mortgage lending market.

If the court below is affirmed, however, creditors who hold claims backed by no real value will be able to impair homeowners' opportunity for a fresh start, and will receive preferential distribution compared to similarly situated unsecured creditors.

To prevent such mischief, and to preserve the careful balance of rights in the Bankruptcy Code, the decision of the court below should be reversed.

I. THE PLAIN LANGUAGE OF THE BANKRUPTCY CODE ALLOWS BIFURCATION OF ANY CLAIM IN A CHAPTER 13 CASE

This case involves the interpretation of 11 U.S.C. §§ 506 and 1322(b)(2). The plain meaning of these sections is that the § 1322(b)(2) prohibition against modification applies only <u>after</u> a determination of whether a claim is a secured claim pursuant to § 506(a).

"[W]here, as here, the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241 (1989) (quoting Caminetti v. United States, 242 U.S. 470, 485 (1917)); Patterson v. Shumate, 504 U.S. ___, 112 S.Ct. 2242, 2247 (1992); Toibb v. Radloff, 501 U.S. ___, 111 S.Ct. 2197, 2199 (1991).

A. Sections 506(a) and 1322(b)(2) Do Not Conflict, and These Sections Can Be Harmoniously Applied in a Chapter 13 Case

The interpretation of §§ 506(a) and 1322(b)(2) begins with the definition of "secured claim". A "claim" is a right to payment from the debtor, or property of the debtor. 11 U.S.C. §§ 101(5)(A), 102(2). See Johnson v. Home State Bank, 501 U.S. ___, 111 S.Ct. 2150 (1991). The

meaning of "secured claim" is found in 11 U.S.C. § 506(a). Section 506(a) provides that a claim that exceeds the value of the collateral is bifurcated, or stripped down, into a secured claim and an unsecured claim. "[s]ubsection (a) of § 506 provides that a claim is secured only to the extent of the value of the property on which the lien is fixed; the remainder of that claim is considered unsecured." Ron Pair, 489 U.S. at 239. Section 506, like all provisions of Chapter 5 of the Code, applies in Chapter 13 proceedings. "[C]hapters 1, 3, and 5 of this title apply in a case under Chapter 7, 11, 12, or 13 of this title." 11 U.S.C. § 103(a).

In a Chapter 13 case, the debtor's plan may modify the rights of holders of secured or unsecured claims, with one exception. Section 1322(b)(2) describes

the permissible contents of a plan as follows:

> (b) Subject to subsections (a) and (c) of this section, the plan may . . .
>
> (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.

11 U.S.C. § 1322(b)(2). Nothing in § 1322(b)(2) states that § 506(a) does not apply when the collateral is the debtor's principal residence. Despite the lack of any such language, the court below adopted the respondent's argument that in a Chapter 13 case § 506(a) does not apply at all to an undersecured creditor who holds a security interest in the debtor's principal residence.

The court below stated that the "no modification" provision of § 1322(b)(2) "appears to conflict with § 506(a)."

Nobleman, 968 F.2d at 488 (emphasis added). Without further examination of whether these two sections actually conflict, the court below then held that the "specific" language of § 1322(b)(2) would prevail over the "general" language of § 506(a). Nobleman, 968 F.2d at 488. The court below ignored its duty to construe these sections to avoid a conflict if possible. See United Savings Association v. Timbers of Inwood Forest, 484 U.S. 370, 371 (1988) (apparently ambiguous language may be clarified when viewed in context of statutory scheme as a whole); Pittsburgh & Lake Erie Ry. Co. v. Railway Labor Executives Ass'n, 491 U.S. 490, 510 (1989) (whenever possible, statutes should be construed so as to avoid a potential conflict).

The court below erred because there is no genuine conflict between §§ 506(a)

and 1322(b)(2). Both sections can be given effect in the same case. Application of § 506(a) results in a finding of how much of a claim is a secured claim. Once that determination is made, then § 1322(b)(2) prevents modification of the rights associated with that claim, such as the interest rate and payment schedule, if the claim is secured only by a security interest in the debtor's home. Bellamy, 962 F.2d at 198; see also, In re Hayes, 111 B.R. 924, 926-28 (Bankr. D. Or. 1990). As the Ninth Circuit correctly observed, these sections "are in harmony when read in the context of the whole statute." Hougland, 886 F.2d at 1184.

The court below adopted an unnatural reading of the statute. It said that the subject matter of § 1322(b)(2) was "the modification of 'the rights of holders of'

claims",[2] rather than the modification of secured "claims". Nobleman, 968 F.2d at 488. The court then construed § 1322(b)(2) to be a prohibition against modification of any of the rights of an entity that is the holder of a secured claim on the debtor's principal residence, including its rights as a holder of an unsecured claim. The more natural reading, adopted by the Ninth Circuit in Hougland, and by the Second, Third and Tenth Circuits, is that the words "other than", refer to their immediate antecedent, "secured claims", and apply only to that portion of the claim that is secured. Therefore, the ban on modification applies to only the secured portion of a claim.

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[2] The court below omitted the word "secured" before "claims" in its quotation of the statute.

Moreover, the method of interpretation used by the court below does not lead to a clear result. Its dissection of the statute fails to account for the placement of the words "holders of unsecured claims" after the "no modification" phrase. An undersecured creditor is, literally, a "holder of an unsecured claim", as well as a holder of a secured claim. There is no language prohibiting modification following the words "holders of unsecured claims". Consistent application of the method of analysis of the court below would allow modification of all of the rights of any entities that are "holders of unsecured claims." A secured creditor who does not also hold an unsecured claim (i.e., a fully secured creditor) is protected from modification; an undersecured creditor whose only security is the debtor's home

could nevertheless have both the secured and the unsecured portions of its claim modified. Thus, the approach that focuses on the creditor, rather than the claim, takes back with one phrase virtually all of what was given with another. This result is illogical and incorrect.

If Congress had meant to protect creditors, rather than claims, it would have referred to creditors "secured only by a security interest in real property that is the debtor's principal residence", instead of claims that are so secured. The use of the word "claims" was part of a consistent design by Congress in the Bankruptcy Code to tailor the rights of secured creditors to their actual economic interests, as opposed to their nominal status as secured creditors. See § II.B., infra. Thus references to "creditors", as opposed to "holders of claims" are rare by

design, not accident. The Code deliberately focuses on the nature of the claim, and not on the identity of the creditor. However, Congress knew how to refer to creditors, as opposed to holders of claims, when that was its intent. See, e.g., 11 U.S.C. § 509 (subrogation rights of codebtors who pay claims of "creditors"); § 523(c)(1) ("creditors" must follow certain procedures to except the debts owed to them from discharge).

There is, therefore, no reason to believe that the phrases "secured claim" and "unsecured claim" in § 1322(b) have any meaning other than those given to them by § 506(a).

B. Congress Created an Express Exception to Stripdown in 11 U.S.C. § 1111(b) and Could Have Done the Same If It Intended to Protect Holders of Residential Mortgages From Stripdown in Chapter 13.

If Congress had intended to create an

exception to stripdown in Chapter 13 for residential mortgage holders, it certainly knew how to do so. Congress enacted an express exception to stripdown in 11 U.S.C. § 1111(b), which provides, in pertinent part:

> (1)(A) A claim secured by a lien on property of the estate shall be allowed or disallowed under Section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless-
>
> (i) The class of which such claim is a part elects . . . application of paragraph (2) of this subsection . . .
>
> (2) If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.

(emphasis added).[3]

Congress' failure to include language in

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[3] For an explanation of § 1111(b), see Howard, Stripping Down Liens: Section 506(d) and the Theory of Bankruptcy, 65 Am. Bankr. L.J. 373, 398 (Spring, 1991).

§ 1322(b)(2) that specifically refers to § 506(a), after it had included such language in § 1111(b)(2), supports the conclusion that the additional protection Congress provided for residential mortgage holders in § 1322(b)(2) does not include insulation from stripdown in Chapter 13.

C. This Court's Decision in Dewsnup v. Timm Does Not Support the Decision of the Court Below.

Although the court below found support for its position in this Court's decision in Dewsnup v. Timm, 502 U.S. ___, 112 S.Ct. 773 (1992), there is only a superficial similarity between the cases. Indeed, after describing Dewsnup, the Court below did not explain why Dewsnup was relevant to this case. See Nobleman, 968 F.2d at 487.

Dewsnup's interpretation of §§ 506(a) and 506(d) in Chapter 7 cases is neither

dispositive nor particularly helpful in cases filed under the reorganization chapters. The issue in Dewsnup was whether a Chapter 7 debtor could use §§ 506(a) and 506(d) to strip down a lien. There is no dispute that a reorganizing debtor in Chapter 11 or 12 can strip down any lien[4], and that a Chapter 13 debtor can strip down any lien other than a lien secured only by the debtor's principal residence. In Dewsnup this Court was reluctant to change prior practice without a clearer indication of legislative intent. It is clear, however, that Congress contemplated that liens would be stripped down in the reorganization chapters. See 124 Cong. Rec. H11107 (Sept 28, 1978) (remarks of Rep. Edwards); 124

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[4] Subject to the possibility of a § 1111(b)(2) election. If stripdown were not allowed in a Chapter 11, § 1111(b)(2) would be superfluous.

Cong. Rec. S17424 (Oct 6, 1978) (remarks of Sen. DeConcini) (secured creditor's lien retained under § 1325(a)(5) only secures the value of the collateral and is satisfied in full by plan payments equal to present value of allowed secured claim). See also, H.R. Rep. No. 595, 95th Cong., 1st Sess. 124 (1977), discussed infra at 32. Since the issue in this case is the scope of an exception to what all parties agree is the general rule allowing lien stripping, nothing in Dewsnup's interpretation of § 506 gives any guidance in this case.

In Dewsnup this Court cautioned that its decision was limited to lien stripping in a Chapter 7 case. Dewsnup, 502 U.S. at ____, 112 S.Ct. at 778, n.3. The failure of the court below to heed this warning led it to the incorrect result in this case.

II. THE DEBTORS' POSITION IS SUPPORTED BY THE OVERALL SCHEME OF THE BANKRUPTCY CODE AND BY THE LEGISLATIVE HISTORY

It has long been recognized that the fundamental purposes of the bankruptcy laws are to provide a fresh start for honest debtors and to ensure equity of treatment among similarly situated creditors. Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., 1st Sess., Pt.I. 75 (1973). These purposes permeate the Bankruptcy Code, including § 506. H.R. Rep. No. 545, 95th Cong. 1st Sess. 340, 429, 118, 124 (1977).

A. 11 U.S.C. § 506 Plays an Indispensable Role in the Overall Scheme of Chapter 13 Which Would Be Undermined If the Respondent's Position Is Adopted.

1. The Purpose of § 506 Is to Recognize the Economic Reality of an Undersecured Creditor's Position, Vis a Vis the Debtor and Other Creditors.

Congress revised § 506(a) with both

the debtor's fresh start and the principle of equity among creditors in mind. The House Report states:

> One of the more significant changes from current law in proposed title 11 is the treatment of secured creditors and secured claims. Unlike current law, H.R. 8200 distinguishes between secured and unsecured claims, rather than between secured and unsecured creditors. The distinction becomes important in the handling of creditors with a lien on property that is worth less than the amount of their claim, that is those creditors who are undersecured. Current law is ambiguous and vague, especially under chapter XIII, on whether an undersecured creditor is to be treated as a secured creditor, or as a partially secured and partially unsecured creditor. By addressing the problem in terms of claims, the bill makes clear that an unsecured creditor is to be treated as having a secured claim to the extent of the value of the collateral, and an unsecured claim for the balance of his claim against the debtor.
>
> The new treatment of secured claims, especially the bifurcation of the claims into secured and unsecured claims, has important protective consequences for both creditors and the debtor. For the creditor, the bill requires that once the secured claim is determined, the court must insure that the holder of the claim

> is adequately protected. The secured creditor is entitled to realize his claim, and not have his collateral eroded by delay or by use by the estate. For the debtor, the determination of the amount of the secured claim facilitates reorganization in the business context, and repayment plans in the consumer context, by defining the precise extent of the claims against the debtor that must be treated specially as secured claims.
> * * *
>
> Because of the uncertain treatment of secured creditors under current law, the debtor is often required to err on the side of overprotection when formulating a reorganization or repayment plan. Secured creditors have exercised great leverage by virtue of the uncertainty, and have made reorganization and individual repayment plans more difficult to consummate than would be the case under this bill. Since a successful reorganization or chapter 13 plan inures to the benefit of all creditors, the change under the bill should increase recoveries by creditors generally.

H.R. Rep. No 595, 95th Cong., 1st Sess. 180-81 (1977) (footnotes omitted).

The importance of § 506(a) is that it

imports into virtually every aspect of bankruptcy law the economic reality of what a security interest is actually worth. A creditor with a security interest, in addition to potential unsecured rights under a loan note, has the right to foreclose or otherwise execute on the security to obtain repayment. However, the security interest is only as good as the underlying collateral.

For example, a $100,000 home may serve as security for an $80,000 first mortgage, a $40,000 home equity loan secured by a second mortgage, and a $30,000 home equity "line of credit" secured by a third mortgage. If the first mortgagee forecloses, it would obtain the full amount of its claim in the foreclosure process. If the second mortgagee forecloses, the first mortgagee

would be paid off, and the second mortgagee would obtain only $20,000 from sale of the property, less any transaction costs. As to the remaining balance, the second mortgagee would then be in the same position as a creditor who never was secured, because it would need to look to the mortgagor's other assets for any deficiency. The third mortgagee could realize nothing by foreclosure, and is nothing more than a completely unsecured creditor.

11 U.S.C. § 506(a) recognizes this economic reality when valuing nominally secured claims. Holders of secured claims get only the equivalent of what they would have received if they had foreclosed. If they were undersecured, the unsecured portions of their claims are treated the same as any other unsecured claims.

No unfairness results, because

creditors get the economic value of their security, all unsecured claims are treated equally and the debtor gets the benefit of a fresh start free of the unjustified leverage which a retained, but economically valueless security interest represents. As stated in the House Report:

> Current chapter XIII does little to recognize the differences between the true value of the goods and their value as leverage. Proposed chapter 13 instead views the secured creditor-debtor relationship as a financial relationship, and not one where extraneous, non-financial pressure should enter. The bill requires the court to value the secured creditor's interest. To the extent of the value of the security interest, he is treated as having a secured claim, entitled to be paid in full under the plan, unless, of course, he accepts less than full payment. To the extent that his claim against the debtor exceeds the value of his collateral, he is treated as having an unsecured claim, and he will receive payment along with all other general unsecured creditors. Of course, the holder of a non-recourse loan will not have an unsecured claim for the deficiency.

> This is an important departure from a few misguided decisions under current law, under which a secured creditor with a $2,000 secured by household goods worth only $200 is entitled in some cases to his full $2,000 claim, in preference to all unsecured creditors.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 124 (1977) (footnotes omitted).

The principles embodied in § 506(a) are so paramount in the Bankruptcy Code that this Court should not find that § 506(a) is negated by some other section, such as § 1322(b)(2), without clear evidence that Congress specifically intended to limit the effect of § 506(a).

2. The Decision of the Court Below Would Make It Possible for Creditors to Circumvent the Bankruptcy Discharge

If the decision of the court below is affirmed, the fresh start that Congress enhanced and protected when it enacted the Code would be vulnerable to wily

creditors. A creditor lending to a homeowner could easily circumvent the discharge by simply taking a mortgage in the transaction. Under the decision below, that mortgage would allow the creditor to demand full payment with interest, even if the mortgage was, in real economic terms, totally worthless, despite the discharge. Such an outcome would severely undermine the potential relief available in bankruptcy, would subvert the reforms enacted in the Bankruptcy Code and would frustrate the debtor's fresh start.

Nothing in the language of the Code compels such a result so at odds with its fundamental purpose of providing a fresh start. It is difficult to believe that Congress intended to permit creditors to obtain so easily what, in effect, would be an advance waiver of the discharge

protections. Considering the elaborate scheme in the statute protecting debtors who might consider reaffirming debts that are dischargeable, 11 U.S.C. §§ 524(c), (d), it is inconceivable that Congress would in the same enactment permit a creditor to achieve the same result as it could through reaffirmation through the device of having the debtor sign a worthless mortgage on totally encumbered property. This is especially so when in another section Congress protected debtors from the in terrorem tactics of creditors holding nonpossessory, nonpurchase-money security interests in household goods. 11 U.S.C. § 522(f). See H.R. Rep. No. 595, 95th Cong., 1st Sess. 126-27 (1977).

3. A Debtor's Chapter 13 Plan That Recognizes the Secured Value Determination Made in a Proceeding Brought Pursuant to § 506(a) Does Not Thereby Modify The Rights of An Undersecured Creditor

Bankruptcy law by its very existence creates numerous modifications of creditors' rights under credit contracts and state law. Clearly Congress did not intend a blanket protection from every provision of the Code for residential mortgage holders. See, e.g., Bellamy, 962 F.2d at 181-82.

The logical conclusion of the respondent's position is that all provisions of Chapters 1, 3 and 5 of the Bankruptcy Code which incidentally modify the rights of residential mortgage holders must be inapplicable to their claims in Chapter 13. But this proves too much. For example, the automatic stay provisions of the Code are found in Chapter 3 of the Bankruptcy Code at 11 U.S.C. § 362. The automatic stay unarguably modifies secured creditors' rights by preventing inter alia a creditor from exercising its rights to

the collateral while the stay is in effect. 11 U.S.C. §§ 362(a)(3),(4). Timbers, 484 U.S. at 371-72.

The only thing which prevents the automatic stay from running afoul of the provisions of 11 U.S.C. § 1322(b)(2) is the language limiting the applicability of that provision to the contents of the debtor's plan. That is, it is not the plan which creates the modification of rights caused by the automatic stay, but rather another provision of the Bankruptcy Code. Consequently, no one would seriously argue that § 1322(b)(2) trumps the automatic stay so that a residential mortgage holder may exercise a right to the collateral while the stay is in effect. Similarly, bifurcation of a claim under 11 U.S.C. § 506(a) is not initiated or effectuated as part of the debtor's plan. Thus stripdown occurs not

as the result of a plan provision, but rather based on application of a wholly separate substantive provision of the Bankruptcy Code. In fact, a number of cases have held that a Chapter 13 plan provision is an inappropriate means to effect a stripdown of any creditor's claim. See, e.g., In re Calvert, 907 F.2d 1069 (11th Cir. 1990).[5]

Since § 1322(b)(2) only limits what the plan can provide, there is no textual basis in § 1322(b)(2) for precluding the debtor from obtaining a § 506(a) valuation. Once a valuation resulting in

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[5] The exact procedure for stripdown is unclear, with some courts requiring an adversary complaint, Fed R. Bankr. P. 7001(2), and others requiring a motion for valuation under Fed. R. Bankr. P. 3012. Compare, e.g., In re Jablonski, 70 B.R. 381 (Bankr. E.D. Pa. 1987), and In re Caster, 77 B.R. 8 (Bankr. E.D. Pa. 1987) (complaint required), with In re Calvert, 907 F.2d 1069, 1072 (11th Cir. 1990), and In re Windfelder, 82 B.R. 367, 370 (Bankr. E.D. Pa. 1988) (motion required).

bifurcation has occurred, a Chapter 13 plan's modification of the unsecured portion of the bifurcated claim does not impinge upon a secured claim, and does not violate § 1322(b)(2).

B. The Applicable Legislative History Supports Use of Stripdown in Residential Mortgages

As discussed above, this case may be resolved in favor of the debtors' position on the basis of the plain language of the Code alone. In addition the weight of the legislative history strongly supports amici's plain language interpretation.

The court below stated that its interpretation of § 1322(b)(2) was consistent with the legislative history of that section. But the same can be said for debtors' position, since it too provides greater protection for qualified home mortgage lenders. Bellamy, 962 F.2d at

181-82 ; Hougland, 886 F.2d at 1184.

If the legislative history of both §§ 506 and 1322 is examined, it supports amici's analysis of the interplay of these two sections and not that of the court below.

As discussed supra at § I.A., the court below went astray when it focused on the status of an entity as a holder of a secured claim, rather than on the secured claim. The legislative history shows that the use of the word "claim" was part of a consistent design by Congress in the Code to tailor the rights of secured creditors to their actual economic interests, as opposed to their nominal status as secured creditors.

The discussion of § 506(a) in the accompanying Senate Committee Report states this clearly.

Section 506. Determination of secured

status.
Subsection (a) of this section separates an undersecured creditor's claim into two parts: He has a secured claim to the extent of the value of his collateral; and he has an unsecured claim for the balance of his claim.
* * *
Throughout the bill, references to secured claims are only to the claim determined to be secured under this subsection, and not to the full amount of the creditor's claim. This provision abolishes the use of the terms "secured creditor" and "unsecured creditor" and substitutes in their places the terms "secured claim" and "unsecured claim."

S. Rep. No. 989, 95th Cong. 2d. Sess. 68 (1978).

Section 506(a) of S. 2266 was identical (except for a comma) to § 506(a) as enacted. See also H.R. Rep. No 595, 95th Cong., 1st Sess. 180-81 (1977). The emphasis in the legislative history of the significance of the word "claim" instead of "creditor" supports amici's plain language analysis of §§ 506(a) and 1322(b)(2).

C. Congress Has Expressed an Awareness That § 1322(b)(2) Does Not Prevent Stripdown of Residential Mortgages.

In post-enactment legislative history, Congress has clearly expressed a belief that stripdown of residential mortgage liens is available in Chapter 13 cases notwithstanding § 1322(b)(2).[6] In 1992, both houses of Congress passed bills which would have amended § 1322(b)(2) to protect some, but not all, residential mortgage liens from the effects of § 506(a) stripdown.[7] S. 1985 would have protected all "primary" security interests and "junior security interests" to the extent they were secured at the time the security interest attached.[8] H.R. 6020 would have protected only the most senior security interest on the property, to the extent it was secured at the time the interest attached.[9]

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[6] This Court has used post-enactment legislative history to interpret statutes. E.g., Anderson Brothers Ford v. Valencia, 452 U.S. 205, 212-19 (1981).

[7] The Senate and House of Representatives passed different bankruptcy bills in 1992. Neither was enacted into law.

[8] S. 1985, §310, 102d Cong. 2d Sess. (1992). That provision reads:

> Section 1322(b)(2) of title 11, United States Code, is amended by striking "claims;" and inserting "claims, but the plan may not modify a claim pursuant to section 506 of a person holding a primary or a junior security interest in real property or a manufactured home (as defined in section 603(6) of the National Manufactured Housing Construction and Safety Standards Act of 1974 (42 U.S.C. 5402(6)) that is the debtor's principal residence, except that the plan may modify the claim of a person holding such a junior security interest that was undersecured at the time the interest attached to the extent that the interest remains undersecured;".

[9] H.R. 6020, § 202 102d Cong., 2d Sess. (1992). That provision stated:

> PRESERVATION OF HOME MORTGAGE LIENS. Section 1322(b)(2) of title 11 United States Code, is amended -
> (1) by striking ", other than a claim secured only by a security interest

(continued...)

This post-enactment legislative history reflects Congressional awareness that current law permits stripdown of all residential mortgages. It also represents a determination in each house of Congress that stripdown of many residential mortgages should continue to be permitted. Although post-enactment legislative history does not control the result in this case, it contributes to the conclusion that Congress did not intend to exclude residential mortgages from the

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[9](...continued)
in real property that is the debtor's principal residence,", and
(2) by inserting before the semicolon at the end the following:
", except that the rights of the holder of a claim secured only by the most senior security interest in real property that is the debtor's principal residence may not be modified to reduce the secured claim to a value that is less than the value, as of the date the security interest arose, of the creditor's interest in the estate's interest in such property".

application of § 506(a) when it enacted § 1322(b)(2).

The legislative history does not support the claims made by respondent and amici urging affirmance that Congress clearly intended § 1322(b)(2) to preclude stripdown of residential mortgages. Furthermore, their attempts to have the courts legislate in this area are misguided. Their arguments have been made to Congress, See § III.C., infra, and should be resolved by Congress, not by this Court.

III. THE DECISION BELOW SUBVERTS THE FUNDAMENTAL PURPOSES OF THE BANKRUPTCY CODE

The decision of the court below makes it more difficult for Chapter 13 debtors to save their homes from foreclosure, thus frustrating the goal of a fresh start for the honest debtor. It also subverts the

goal of equity between similarly situated creditors. The argument that debtors' loss of their homes, and the violation of basic bankruptcy principles, is justified by larger policy concerns is not supported by empirical data.

A. Prohibiting the Stripdown of Undersecured Mortgages Would Make it More Difficult For Families to Save Their Homes Through Bankruptcy

Probably the most common and important reason that a debtor chooses to file a Chapter 13 case rather than a Chapter 7 case is to use the provisions that Congress placed in Chapter 13, but not in Chapter 7, which permit debtors to cure or pay off home mortgage debts. A decision by this Court affirming the court below would make it more difficult and, in some cases, impossible, for families to save their homes through Chapter 13, and push more debtors towards Chapter 7. This

would be contrary to Congress' intent when it enacted the Bankruptcy Code, which was to make Chapter 13 more available for saving homes from foreclosure. Collier on Bankruptcy, ¶ 1322.09[2].

The frequent use of Chapter 13 to save families' homes is well known. In Matter of Brunson, 87 B.R. 304, 307 (Bankr. D.N.J. 1988), the court noted that 70% to 80% of the Chapter 13 cases filed in New Jersey represented debtors' attempts to save their homes. A recent comprehensive study of bankruptcy debtors states that "the picture of homeowners in bankruptcy is one of people struggling to keep their homes." Sullivan, Warren and Westbrook, As We Forgive Our Debtors 143 (1989).

In a typical Chapter 13 plan, the bulk of the debtor's disposable income is used to cure or pay off a home mortgage.

The remaining income goes first to pay other secured debts in full, and only at the end to the holders of unsecured claims. See 11 U.S.C. §§ 1322(b)(5), 1325(a)(5) and 1325(b). Even in the Western District of Pennsylvania, where stripdown of home mortgages has been practiced for many years, over two-thirds of the distributions made in 1992 by amicus Gary J. Gaertner, the Standing Chapter 13 Trustee for that District, were to secured creditors, principally for home mortgages.

In many cases debtors have barely enough income to deal with their mortgage obligations through the Chapter 13 plan. In cases where mortgage stripdown is at issue, there is by definition no equity in the debtor's principal asset, the home, and so it is unlikely that the "best interests" test, 11 U.S.C. § 1325(a)(4),

would require substantial payments to unsecured creditors before the debtor obtained a discharge. 11 U.S.C. §§ 1325(a)(4), 1328. See generally Collier on Bankruptcy ¶¶ 1325.05, 1328.

In contrast, a creditor holding a secured claim that is to be paid under a Chapter 13 plan[10] is entitled to demand that its allowed secured claim be paid in full, with "present value" interest to compensate for the deferral of payments, or that any defaults be cured and all postbankruptcy payments be made. 11 U.S.C. §§ 1322(b)(3),(5), 1325(a)(5). See Collier on Bankruptcy ¶¶ 1322.07, .09;

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[10] Instead of paying a secured creditor through the plan, a debtor may surrender the collateral, or choose not to deal with a secured creditor in the plan. However, such a creditor may obtain relief from the automatic stay to foreclose on its collateral or exercise other nonbankruptcy remedies. See Collier on Bankruptcy ¶ 1325.06[2][b].

1325.06[2][c]. The bankruptcy court may decline to confirm a plan that does not meet one of these requirements.[11]

The significance of these principles to the case before the court is demonstrated by the circumstances of amicus Clifford Moses. Mr. Moses first purchased his home in 1985 for $10,000, financed by a purchase money mortgage for all or virtually all of the purchase price. Several years later he obtained a loan of $3,000 from a finance company. Although the home had not appreciated in value, the finance company took a second mortgage on the property. When Mr. Moses recently experienced financial problems, he defaulted on both loans and filed a

[11] However, if a creditor fails to object to confirmation it may be deemed to have waived this right or accepted the plan and the plan may be confirmed. In re Szostek, 886 F.2d 1405 (3d Cir. 1989). See also Collier on Bankruptcy ¶ 1325.01[1].

Chapter 13 case. Under the governing law in the Third Circuit, he then sought a valuation of his property so that the secured status of the second mortgage could be determined pursuant to § 506(a). The parties recently stipulated that there was no equity over and above the first mortgage, and the debtor's plan providing for the second mortgage claim as an unsecured claim now awaits confirmation.

Absent the ability to strip down the second mortgage on his home, it is very doubtful whether Mr. Moses could save his home in bankruptcy, since he does not have sufficient income to cure or pay off both his first and second mortgages. Yet, under the decision of the court below, that would be the only way to deal with both debts in a Chapter 13 case. As the holder of a secured claim, the second mortgage holder could demand payment in

full, with interest, and threaten to scuttle the Chapter 13 case, even though in reality it is nothing more than an unsecured creditor. The ability to hold a Chapter 13 plan hostage would give this creditor undue bargaining power in view of its totally unsecured position.

The situation of Mr. Moses is common, and is mirrored in the situation of amici Ruby Lee Bradley and Ethel Cork. Mrs. Bradley and Ms. Cork both gave second mortgages as security for home improvement loans that have added little if any value to their homes. Neither can afford to pay both the first and second mortgage payments on their homes.

Mrs. Bradley could possibly win her appeal of the denial of confirmation of her Chapter 13 plan if she can show factually that her second mortgage is totally unsecured, and if she can then

prevail on her legal argument that, even under the decision of the court below, a holder of a security interest in a debtor's home who is not secured by any actual value does not qualify as the "holder of a secured claim" entitled to the special protection of § 1322(b)(2). However, if the holder of her second mortgage can show that it is secured in any amount, even one dollar ($1.00), under the decision of the court below she would have to pay the entire balance of the debt. The absurdity of this potential result shows the inherent flaws in the decision of the court below.

The decision of the court below would frustrate debtors' ability to save their homes and flies in the face of the Code's purpose of providing a fresh start.

B. The Decision of the Court Below Contravenes the Bankruptcy Code's Policy of Treating Similarly Situated Creditors Equally

Bifurcation of claims into their secured and unsecured components is an integral part of the Code's balance between the rights of secured and unsecured creditors. Timbers, 484 U.S. at 373. Bifurcation ensures that wholly unsecured creditors receive the same treatment for their claims as partially secured creditors receive for the unsecured portion of their claims.

In Timbers, relying both on the language and structure of the Code as well as pre-Code practice, the Court declined to adopt a result that would permit undersecured creditors to receive interest on their allowed secured claims before unsecured creditors received any payment. "To allow a secured creditor interest

where his security was worth less than the value of his debt was thought to be inequitable to unsecured creditors." (citing Vanston Bondholders Protective Committee v. Green, 329 U.S. 156, 164 (1946)). Timbers, 484 U.S. at 373.

In this case, an undersecured creditor seeks not simply interest on its secured claim, but also principal and interest on its unsecured claim, to be paid prior to any payment to unsecured creditors. If the creditor is successful in these efforts, this would violate the principle of equity among similarly situated creditors. Every additional dollar paid to an undersecured creditor delays or prevents a payment to the general unsecured creditors.

Bifurcation of claims in § 506(a) is designed to recognize the real world economic rights of creditors to the

debtor's property at the time of a bankruptcy case. Creditors are given the special treatment accorded by the Code to holders of secured claims only to the extent they have security that has economic value. Beyond that, the bankruptcy policy of equity among creditors dictates that they be treated identically with wholly unsecured creditors. The decision of the court below directly contravenes this fundamental bankruptcy policy.

C. Experience Has Demonstrated That the Ability of Debtors to Strip Down Mortgage Liens Has No Perceptible Effect on the Purchase Money Mortgage Market

The respondent and other mortgage lenders will undoubtedly argue, as they argued below and have argued to Congress, that permitting stripdown of home mortgages will have a grave impact on

credit markets, making mortgage lending riskier, driving up the costs of such credit, reducing its availability and frustrating the American dream of home ownership. History has proved this argument to have no factual basis.

Courts have permitted the stripdown of mortgages in bankruptcy since at least 1981. In re Tanner, 14 B.R. 933 (Bankr. W.D. Pa. 1981). Stripdown of mortgages has been uniformly allowed in the Eastern District of Pennsylvania for almost ten years, see, e.g., In re Caster, 77 B.R. 8 (Bankr. E.D. Pa. 1987); In re Spadel, 28 B.R. 537 (Bankr. E.D. Pa. 1983), in the Ninth Circuit since 1989, Hougland, and in the Third Circuit since early 1990. Wilson.

During this entire period, no evidence has ever been brought forth that the availability of stripdowns has had any

impact at all on the mortgage market. Since real estate values plummeted during this period and the number of bankruptcy cases reached record highs, if there ever was to be an impact it would have occurred during that time. And, in view of the enormous effort that mortgage lenders have put into litigation and lobbying on this issue, if there were any evidence of stripdown's adverse impact on the market, we can be confident that it would have been produced. In fact, as is well known, mortgage interest rates have dropped significantly.

The lack of an adverse impact from mortgage stripdowns is not surprising in light of economic realities.

In the first place, the number of Chapter 13 debtors who stripdown purchase money mortgages is relatively small. Homeowners rarely file bankruptcy unless

they are in danger of foreclosure or in serious financial distress. Even respondent does not contend that there is a horde of consumers without serious financial problems filing Chapter 13 cases simply to strip down liens. At any given time less than one percent of homeowners are facing foreclosure, and only a fraction of them will ever file a Chapter 13 bankruptcy.

Second, since most purchase money loans are made to consumers who have paid down payments of 5% to 20%, giving the lender an equity cushion, many loans that are in foreclosure are not eligible for stripdown.

Third, stripdown is no worse for the lender than the most likely alternative, foreclosure. Stripdown helps the buyer to stay in the home by paying what the property would be worth to a stranger to

the property, which is all the lender could expect if it foreclosed. Furthermore, the Chapter 13 debtor must make current payments or face dismissal or lifting of the automatic stay, while there may be a substantial fallow period if the lender forecloses and has to find a new buyer in a depressed market.

Finally, even in the case where a purchase money mortgage is stripped down due to a decline in the market, the lender or guarantor does not lose the entire investment. Thus, the impact on first mortgage lenders is not nearly as drastic as has been portrayed by their advocates.

The bigger impact of stripdown occurs in the cases of second, third and fourth mortgages, where often there was never any significant equity to encumber and the lender could never have realistically relied upon the property for the payment

of its claim. Such mortgages are valuable to creditors because they can be used to threaten families with foreclosure if payment is not made (despite the fact that foreclosure would be unlikely) or to try to obtain an advantage over other creditors in a subsequent bankruptcy case. No bankruptcy policy or public policy is served by protecting lenders in such cases.

CONCLUSION

For all the foregoing reasons, the decision of the Fifth Circuit should be reversed in favor of the position taken by the Second, Third, Ninth and Tenth Circuits.

Respectfully submitted,

HENRY J. SOMMER
Counsel of Record

COMMUNITY LEGAL SERVICES, INC.
3207 Kensington Avenue
Philadelphia, Pennsylvania 19134
(215) 427-4898

DAVID S. YEN
LEGAL ASSISTANCE FOUNDATION OF CHICAGO
852 West 63rd Street
Chicago, Illinois 60621

GARY KLEIN
JOANNA GEORGE
NATIONAL CONSUMER LAW CENTER
11 Beacon Street
Boston, Massachusetts 02108

DANIEL L. HALLER
NEIGHBORHOOD LEGAL SERVICES ASSOCIATION
928 Penn Avenue
Pittsburgh, Pennsylvania 15222

LAWRENCE YOUNG
NORTH MISSISSIPPI RURAL LEGAL SERVICES
2134 West Jackson Avenue
P.O. Box 767
Oxford, Mississippi 38655

Attorneys for Amici Curiae